Nos. 77-1859 and 78-295

In the Supreme Court of the United States

OCTOBER TERM, 1978

JERE N. HELFAT, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

KORACORP INDUSTRIES, INC., ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 4-23)[1] is reported at 575 F. 2d 692. The opinion of the district court (Pet. App. 1-3) is not officially reported.

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[1]"Pet. App." references denote the appendix in No. 77-1859.

JURISDICTION

The judgment of the court of appeals was entered on February 6, 1978. Rehearing was denied on May 24, 1978. The petitions for a writ of certiorari were filed on June 29, 1978 (No. 77-1859) and August 22, 1978 (No. 78-295). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, in an action to enjoin petitioners and others from future violations of the securities laws, the extent of petitioners' involvement in an admittedly fraudulent scheme is a "material fact" that, when disputed, precludes summary judgment in petitioners' favor under Fed. R. Civ. P. 56(c).

STATEMENT

Petitioners in No. 78-295 are Koracorp Industries, Inc. ("Koracorp"), a corporation whose common stock is traded on the New York Stock Exchange and the Pacific Coast Exchange, and Koratec Communications, Inc. ("KCI"), Koracorp's wholly-owned subsidiary. Petitioner in No. 77-1859 is Jere N. Helfat, who was the chief executive officer and president of Koracorp.

The Securities and Exchange Commission brought this action against petitioners and others[2] in the United States District Court for the Northern District of California,

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[2]The Commission also named as defendants in this action Arthur Andersen & Co., Koracorp's independent auditor; Arthur Cunningham, vice-president and a director of Koracorp; Phillip Weil, president of KCI; and a group of corporations (Western Gateway Corporation, Verve, Inc., Associated Graphics, Inc., and Allison Production Affiliates, Inc.) that Weil controlled.

alleging violations of antifraud[3] and reporting[4] provisions of the federal securities laws and seeking to enjoin each of the defendants from further violations of these provisions.

It is undisputed that KCI improperly inflated its accounts receivable in 1970, 1971 and 1972. Because KCI's financial statements were consolidated with those of Koracorp, the latter's reported income for 1972 had to be decreased by more than $5 million when the fraud was discovered. As a result, Koracorp's revised statement of earnings showed a loss of $1.02 per share for that year, instead of a profit, as originally reported (Pet. App. 5-7).

Evidence presented by the Commission indicated that the principal architect of this fraud was defendant Phillip Weil, the president of KCI from 1971 through August 3, 1973 (Pet. App. 5). Weil's compensation at KCI was, for a period, tied to the amount of business the company did; the SEC charged that, in order to increase his compensation, Weil caused to be placed and carried on KCI's books millions of dollars in spurious receivables (*ibid.*).

The SEC sought relief against petitioner Helfat (and other defendants) because they appeared either to have been active participants in Weil's scheme or to have closed their eyes to clear evidence of his fraud prior to the public exposure of his scheme, and they thus failed in their duty to the corporation's stockholders (Pet. App. 8). For example, Arthur Andersen & Co., Koracorp's auditors, had in 1970, 1971 and 1972 informed petitioner Helfat of the

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[3]Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a); Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. 240.10b-5.

[4]Section 13(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78m(a), and Rules 13a-1 and 13a-13 thereunder, 17 C.F.R. 240.13a-1, and 240.13a-13.

unsatisfactory records and internal controls of KCI. On more than one occasion, changes were purportedly instituted in the manner that accounts receivable were recorded, contracts administered, and reserves set up for long past-due receivables (Pet. App. 6). But, in fact, petitioner Helfat never took the steps necessary to correct the receivables problem; none of the new policies was complied with, and the lax internal controls at KCI persisted.[5]

On May 3, 1973, the day before scheduled meetings of Koracorp's board of directors and stockholders, the accounts receivable problem was again brought to the attention of petitioner Helfat.[6] Although the board of directors of Koracorp was informed of the KCI receivables problem at that time, Helfat decided not to inform the corporation's shareholders of the company's problems; he instead assigned Koracorp's controller to investigate. No substantial action was taken until August 1973, when Arthur Andersen & Co. was directed to conduct a special investigation of the KCI situation.[7]

At a special meeting of the board of directors on August 7, 1973, Weil resigned as president of KCI (Pet. App. 7). After this meeting, Koracorp finally informed the New York Stock Exchange and the Pacific Coast Stock

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[5]Gourley Aff. B, Ex. 2 (R. 1143).

[6]Postyn Tr. (October 10, 1973) 20.

[7]Weil Tr. (April 25, 1974) 215. The controller did not begin his investigation until June 13, 1973, but by the end of June he was sufficiently concerned to request that Helfat call a meeting at which Weil would be required to explain in detail the situation with respect to KCI receivables. Helfat delayed calling this meeting until early August 1973. Kittleberger Tr. (October 10, 1973) 13, 16, 18; Helfat Tr. (December 4, 1973) 114.

Exchange of the KCI problem. The Commission was also informed, and, on August 8, 1973, it suspended all trading in Koracorp securities (*ibid.*), in order to allow sufficient time for Koracorp to provide shareholders with all material information concerning the KCI receivables fraud and its effect on Koracorp's financial statements.

At a meeting of the board of directors on August 24, 1973, Helfat was requested by the board to resign as president and a director of Koracorp; he was retained, however, as a special consultant to the company at his full salary of $95,000 per year, plus all fringe benefits. In addition, Koracorp's vice-president (and director) Cunningham was asked to resign and, after having refused to do so, was removed by board resolution from his position as a corporate officer (Pet. App. 8).

When the SEC brought this action to enjoin petitioners and others from future violations, petitioners (and other defendants) moved for summary judgment. Without attempting to determine the degree of responsibility of each of the defendants for what had occurred, the district court granted the motions of all defendants for summary judgment. The court accepted the defendants' suggestion "that the nature of the defendants' activities in connection with the violations was not significant in deciding whether injunctions should issue" and "accordingly restricted the inquiry into the conduct of the parties after the exposure of the fraud in August 1973" (Pet. App. 9). Limiting its consideration to the defendants' conduct after the principal violations alleged by the Commission had occurred, the district court concluded that "[t]here is no showing whatsoever of any violations by these parties in the last 18 months, and no facts have been alleged upon which the court could conclude that there is any expectation of further violations" (Pet. App. 2).

The court of appeals reversed the district court's grant of summary judgment in favor of petitioners.[8] It held that the central issue is "whether as a matter of law the district court could conclude that 'there was no significant threat of future violation"; and, the court held, "the nature and extent of the culpability of the several defendants is a material fact" in that determination—a disputed fact that could not be determined on a motion for summary judgment (Pet. App. 11).

ARGUMENT

The decision of the court of appeals is correct and raises no issue warranting review by this Court. There is no conflict with prior decisions of this Court, and petitioners do not suggest that there is a conflict among appellate decisions. The case involves no more than the application of acknowledged principles to particular facts.

Petitioners contend that there is no disputed issue of material fact because the issue on which the parties concededly disagree—the extent to which the various defendants participated in the violations of law—is not material to the question whether injunctive relief should be awarded. All sides agreed that the evidence of participation by the various defendants would be in sharp conflict if introduced (Pet. App. 10); thus the question that controls the propriety of summary judgment is whether the extent to which individual defendants violated the law in the past is material to the question whether they are likely to continue to violate the law in the future and thus should be subject to restraint. The court of appeals held that the extent of past participation

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[8]The court of appeals affirmed summary judgment in favor of Arthur Anderson & Co. (Pet. App. 16-22). That ruling is not before this Court.

is indeed material. In the court's words: "Assessing the likelihood of recurrent violations of the securities laws requires a prediction of future conduct and that, in turn, requires the court to probe the defendants' states of mind. Two facts are critical to this inquiry: 'the character of past violations' and 'the bona fides of the expressed intent to comply.' (*United States* v. *W.T. Grant Co.* [345 U.S. 629 (1953)] * * *.)" (Pet. App. 14). The court then reasoned that "[n]either the character of a defendant's past violations nor the bona fides of an expressed intent to comply can be ascertained without determination of the acts and conduct of each of these defendants in connection with the securities violations." *Ibid.* The court is clearly right. A district court cannot intellegently exercise its ample discretion to shape relief until it knows what each defendant did and can separate the knaves from the negligent.

Petitioners argue, however, that the decision of the court of appeals is contrary to *United States* v. *W. T. Grant Co.*, 345 U.S. 629 (1953), and *Hecht Co.* v. *Bowles*, 321 U.S. 321 (1944). But those cases did not hold, as petitioners suggest (Helfat Pet. 9-12; Koracorp Pet. 9-12), that the nature of past acts or predictions of future ones are irrelevant on motions for summary judgment. The question was not presented in those cases, for they involved no dispute about the underlying facts.

In *W. T. Grant* the individual defendant had served on the boards of directors of three pairs of corporate defendants alleged to be in competition. The defendants filed affidavits stating that "the interlocks no longer existed * * *" and disclaiming "any intention to revive them" (345 U.S. at 633). The government conceded "the truth of the defendant's affidavits * * *" (*id.* at 635) and did not itself seek to introduce any conflicting evidence. As this Court pointed out, "In these circum-

stances, the District Judge could decide that there was no significant threat of future violation and that there was no factual dispute about the existence of such a threat." *Ibid.*

In *Hecht Co.*, which involved the question whether the district court was *required to* issue an injunction once a violation of the Emergency Price Control Act was shown, this Court similarly found that there was "no substantial controversy as to the facts," 321 U.S. at 324, and that the district court had "concluded that the mistakes * * * were all made in good faith and without intention to violate the regulations." *Id.* at 325.

In contrast to those cases, many of the circumstances concerning the activities of the defendants in this case are still unknown. What is known, as the court of appeals noted, is that "[o]ne or more of these defendants was responsible for gross fraud, for diversion of corporate funds, and for active cover-up of the misdeeds" (Pet. App. 15). In this Court petitioners, as all the defendants did in the courts below, contend that, whatever the scope of the fraud, the finger should be pointed at some other defendant—each asserts that his own culpability is minimal or irrelevant (Koracorp Pet. 6; Helfat Pet. 14-15). Contrary to petitioner Helfat's assertion (Pet. 13), the court of appeals did not, of course, decide who was properly subject to injunction and who was not (see Pet. App. 16 n.3). It merely found that, on this record, the district court could not properly make a blanket finding that no defendant should be enjoined. It may well be that, after further hearings, the district court will come to that conclusion. But to reach that decision it cannot rely on " 'admissions' that violations occurred for which responsibility need not be allocated" (Pet. App. 14). Rather it must "explor[e] * * * the nature and quality

of the conduct of each defendant * * *" (*ibid.*).[9] Until that task is done, petitioner Helfat's request that this Court decide whether injunctive relief is proper for merely negligent violations of the securities laws (Pet. 19-30) is premature.

Petitioners' argument (Koracorp Pet. 17-19; Helfat Pet. 12) that the court of appeals erred in holding that "the district court improperly allocated the burden of persuasion on motion for summary judgment" (Pet. App. 9) is incorrect. Under Fed. R. Civ. P. 56(c), the district court's first task in ruling on a motion for summary judgment is to determine whether any genuine issue of material fact exists. *United States* v. *Diebold, Inc.*, 369 U.S. 654, 655 (1962); *Radobenko* v. *Automated Equipment Corp.*, 520 F. 2d 540, 543 (9th Cir. 1975). When material facts are in dispute, they may not be resolved on motion for summary judgment. Accordingly the court of appeals correctly concluded that the parties moving for summary judgment must "clearly * * * establish the nonexistence of any genuine issue of fact material to judgment in their favor" and that "all factual inferences are to be taken against the moving party and in favor of the opposing party" (Pet. App. 11, 12). See *Radobenko* v. *Automated Equipment Corp., supra,* 520 F. 2d at 543; *Caplan* v. *Roberts,* 506 F. 2d 1039, 1042 (9th Cir. 1974).

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[9]Petitioner Koracorp's argument (Pet. 12-17) that the court of appeals applied an incorrect standard of review under *W. T. Grant Co.* in reversing the district court, and petitioner Helfat's contention (Pet. 17-19) that the court applied to him a standard inconsistent with that it applied to Arthur Andersen, are insubstantial. *W. T. Grant* required a showing of abuse of the district court's discretion (345 U.S. at 629-630), and that is the standard the court of appeals applied here to Arthur Anderson's case (Pet. App. 9, 21) once it found that no material facts concerning that defendant were in dispute. Because it found that there is a dispute of material fact concerning petitioners, the court of appeals had no occasion to reach the question whether the district court abused its discretion (Pet. App. 9).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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